In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 159

UNIVERSAL OIL PRODUCTS COMPANY, PETITIONER

v.

NIGEL D. CAMPBELL and THE UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE RESPONDENTS

OPINIONS BELOW

The District Court wrote no opinion. The opinion of the Court of Appeals (R. 1058-1104) is reported at 181 F. 2d 451.

JURISDICTION

The judgments of the Court of Appeals were entered on April 6, 1950 (R. 1105-1108). The petition for a writ of certiorari was filed on June

29, 1950. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Taxpayer-corporation is engaged exclusively in business for profit, its activities consisting primarily of obtaining patents in the petroleum field and licensing its patents to small oil companies on a royalty basis. In 1944, taxpayer's stockholders, several major oil companies, transferred their stock in trust for a tax exempt scientific organization, but taxpayer continued thereafter to carry on its business as before. Under contracts entered into between taxpayer and its former stockholders, the latter are licensed to use taxpayer's patents free of charge, while all other licensees are required to pay royalties to taxpayer.

The question presented is whether, by virtue of the 1944 transfer of its stock, taxpayer became entitled to exemption from federal income tax under Section 101(6) of the Internal Revenue Code as a corporation "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes".

STATUTE AND REGULATIONS INVOLVED

These appear in the Appendix, *infra,* pp. 16-18.

STATEMENT

The material facts as found by the District Court and shown by the evidence [1] may be summarized as follows:

Taxpayer is a Delaware corporation organized in 1932 as successor to the business and substantially all of the assets of another corporation of the same name. Since its organization and throughout the taxable years (1944-1946) it has been engaged exclusively in business for profit. It conducts research in the hydrocarbon field, particularly crude oil, obtains patents on oil refining processes devised by it, and licenses its patents for commercial use. It also furnishes designing and engineering services to its customers, and manufactures and sells certain chemicals called catalysts and inhibitors. Its customers are small and independent oil refiners who do not have adequate experimental and engineering facilities of their own. (R. 923, 930-931; Ex. E, Riders C and F.) During the taxable years, taxpayer owned more than 2,000 patents, had between 600 and 1,000 patent applications pending,

[1] Some of the material and undisputed facts do not appear in the District Court's findings, which were adopted as proposed by taxpayer, but appear in the voluminous documentary exhibits which by stipulation of the parties (R. 1052-1053) were not included in the printed record filed in the court below. These exhibits have been transmitted to the Clerk of this Court, the parties having stipulated that they need not be included in the printed record for purposes of disposition of the petition for certiorari. A summary of the undisputed facts is contained in the opinion below. (R. 1060-1066.)

and was granted 382 United States patents and 142 foreign patents (Exs. 52-54, 134-135, EE, FF). Its operations are carried on in its principal office in Chicago and in a plant near Riverside, Illinois (R. 923, 931-933). Taxpayer's reported gross income for 1944 amounted to $7,167,281, for 1945 it was $6,070,432 and for 1946 it was $4,582,783; the bulk of this income represented royalties received from licensees of its patents (Ex. 93, SS, TT).

On October 26, 1944, all of taxpayer's stock and securities were owned by the following companies: Shell Oil Company, Inc.; Standard Oil Company of California; Standard Oil Company (Indiana); Standard Oil Company (New Jersey); The Texas Company; Phillips Petroleum Company; N. V. de Bataafsche Petroleum Maatschappij. The securities outstanding consisted of 120,000 shares of A stock, 100 shares of C stock, 100 shares of S stock, and $8,500,000 principal amount of C and D income Notes. (Ex. A to complaint, R. 6-7; Ex. E, Riders A, B and C.)

Between October 26 and November 29, 1944, taxpayer's stockholders transferred their stock and notes to the Guaranty Trust Company of New York, as trustee of a "Petroleum Research Fund", for the benefit of the American Chemical Society. Under the trust indenture, the trustee was to pay the net income of the trust (distributions from taxpayer-corporation, less expenses of the trust) to the American Chemical Society, which was to use the

income exclusively for scientific education and research in the petroleum field. Unless directed by court order, the trustee was prohibited from disposing of any of the securities of taxpayer, or from causing taxpayer to discontinue its ownership and licensing of patents. (R. 6-19, 925-926.) Following the transfer of its stock to the Guaranty Trust Company, taxpayer's charter was amended to provide that it was organized and operated exclusively for charitable, scientific, or educational purposes; that no part of its net earnings should inure to the benefit of any private shareholder; but that nothing in the amended charter should be deemed to prevent taxpayer "from continuing to be operated as a stock and business corporation for profit." (Ex. 6 to Rider C of Ex. E). The provisions of the charter authorizing taxpayer to engage in a wide range of business activities for profit were left intact (Ex. E, Rider F, par. "Third").

Under contracts entered into from 1931 to 1939 between taxpayer (or its predecessor) and the oil companies which then owned its stock, the latter acquired the right to use royalty-free all of taxpayer's patents based on inventions made by taxpayer prior to July 1, 1947. The Phillips Petroleum Company acquired such right with respect to patents based on inventions made by taxpayer prior to August 14, 1956. (Exs. 40-80.) Royalties paid to taxpayer by the independent oil companies for the use of taxpayer's patents amounted

to over $4,000,000 for each of the taxable years 1944 and 1945, and over $3,000,000 for the taxable year 1946 (Exs. 93, SS, TT).

Taxpayer's net income for the taxable years as shown by its tax returns amounted to $3,710,727 for 1944, $2,727,326 for 1945, and $901,529 for 1946 (Exs. 93, SS, TT). It distributed nothing to the Guaranty Trust Company during 1944 or 1945. In 1946, it paid to the Guaranty Trust Company interest on its C and D notes in the total amount of $258,963. The Guaranty Trust Company paid itself fees for its services and other expenses out of this amount, and turned over the balance to the American Chemical Society. (Exs. 25-27 of Ex. 90; Ex. E, Rider C.)

The Commissioner of Internal Revenue ruled that both the Guaranty Trust Company, as trustee of the Petroleum Research Fund, and the American Chemical Society, as beneficiary of the trust, were exempt from tax on their income under Section 101(6) of the Internal Revenue Code (R. 20-21, 928-929). The Commissioner refused, however, to grant taxpayer's request for a ruling that it was exempt from tax on its own income (R. 22-23, 924-925). Taxpayer filed income and excess profits tax returns for each of the three taxable years, paid the taxes disclosed by the returns, and filed claims for refund alleging that it was exempt from tax for the period subsequent to the transfer of its stock to the

Guaranty Trust Company. The Commissioner rejected the claims and also notified taxpayer of deficiencies in tax, and suits for refund followed. (R. 923-925.) The District Court, without opinion, held that taxpayer was exempt from federal income and excess profits taxes and directed judgment for taxpayer (R. 945-957). The Court of Appeals reversed on the ground that taxpayer was neither "organized" nor "operated" for the purposes specified in Section 101(6) (R. 1060-1080).

DISCUSSION

1. To be exempt from federal income tax under Section 101(6) of the Internal Revenue Code (Appendix, *infra*, p. 16), a corporation must, among other things, be "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes." On the basis of the undisputed evidence, the court below concluded (R. 1076-1080) that taxpayer was not "operated exclusively" for scientific or educational purposes, but primarily for the benefit of the major oil companies who were its former stockholders. After donating their stock to a tax exempt institution, these companies retained the right to use royalty-free all of taxpayer's patents and inventions. The small independent companies were required to pay substantial royalties to taxpayer, and thus were made to finance the research work the benefits of which the major

companies received *gratis*. As the court below pointed out (R. 1077, 1079, 1080)—

> * * * The donors [major oil companies] thus provided that the plaintiff should continue to carry on the research, development and patent work in the petroleum field, work which was to be financed primarily by the small independent oil companies, work the results of which, for years to come, could be used royalty free by the donors and their subsidiaries. * * *
>
> * * * Here * * * the entire business of plaintiff was for the business betterment of those engaged in the petroleum industry and especially of the major oil companies who were to receive without cost the benefits of all of the plaintiff's discoveries or inventions. * * *
>
> * * * * *
>
> In the instant case the scientific or educational purpose of plaintiff's operation instead of being exclusive was only incidental to the primary purpose of research, development, and securing patents in the petroleum field for the benefit of the petroleum industry and particularly for the major oil companies, in order to improve their business, increase their sales and thereby secure to them greater profits. Resulting benefits to the public were only incidental.

These factual conclusions are not specifically challenged by taxpayer, and they completely dispose of its contention that it is "organized and operated exclusively" for scientific and educational purposes. Unless they are ignored, there is no

occasion here for reaching and deciding the broad question to which the petition for certiorari is addressed, namely, whether a business corporation is to be deemed "organized and operated exclusively" for the purposes specified in Section 101(6) solely by reason of the transfer of its stock to a tax exempt organization. That question is of general importance, and one with respect to which the decisions of the lower courts are inconclusive. Should this Court be disposed to reach and resolve it in this kind of case, the Government would have no objection to the granting of the writ for that purpose. But before undertaking to do so, the Court may wish to await a case which squarely presents the question, such as *C. F. Mueller Co.* v. *Commissioner,* 14 T. C., No. 111 ½, decided May 25, 1950, pending on appeal in the Court of Appeals for the Third Circuit.[2] Since the instant case presents a rather unique factual situation which affords independent ground for denial of the exemption, it is not the most suitable vehicle for resolution of the question.

2. The decision below is correct even if this case were viewed as presenting the bare question of

[2] In the *Mueller* case, all of the stock of a macaroni company was acquired by an educational institution. It seems to raise squarely the issue whether an otherwise non-exempt business corporation achieves an exempt status merely because its stock is acquired by a tax exempt institution and its earnings are to be dedicated ultimately to that institution. It does not appear to involve any extraneous factors, as does the instant case, such as the free use of the taxpayer-corporation's property by its former stockholders.

whether a business corporation becomes tax exempt by virtue of the acquisition of its stock by a tax exempt organization. Section 101(6) exempts from federal income tax a corporation which (1) is "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes"; and (2) "no part of the net earnings of which inures to the benefit of any private shareholder or individual." Compliance with the second condition does not dispense with the necessity for compliance with the first. The corporation, as distinguished from its shareholders, must be organized and operated for the specified statutory purposes. A conventional business corporation engaged solely in profit-seeking business activities does not qualify for tax exemption merely because its earnings inure to the benefit of a tax exempt stockholder. It is not transformed into one "organized and operated exclusively" for charitable and like purposes simply because its stock is transferred to another corporation which is organized and operated for such purposes, nor is it endowed with immunity from tax on its own income simply because its stockholders are immune from tax on their income. The only corporations to which Congress has accorded tax exemption by virtue of the fact that their stockholders are tax exempt are those described in Section 101(14) (Appendix, *infra*, p. 16), namely, corporations "organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the

entire amount thereof, less expenses, to an organization which itself is exempt".[3] Taxpayer admittedly does not fall within that classification. The decision below is in accord not only with the controlling statutory provisions, but with the long-standing implementing Treasury Regulations (Sec. 29.101(6)-1 of Treasury Regulations 111 under the Code, Appendix, *infra*, pp. 17-18), and the applicable decisions of this and other courts. *Better Business Bureau* v. *United States*, 326 U. S. 279; *Trinidad* v. *Sagrada Orden*, 263 U. S. 578, 582; *Bear Gulch Water Co.* v. *Commissioner*, 116 F. 2d 975 (C. A. 9th), certiorari denied, 314 U. S. 652; *Gagne* v. *Hanover Water Works Co.*, 92 F. 2d 659 (C. A. 1st); *Underwriters' Laboratories* v. *Commissioner*, 135 F. 2d 371 (C. A. 7th), certiorari denied, 320 U. S. 756; *Sun-Herald Corp.* v. *Duggan*, 73 F. 2d 298 (C. A. 2d), certiorari denied, 294 U. S. 719; 160 F. 2d 475; *C. F. Mueller Co.* v. *Commissioner*, 14 T. C., No. 111½.[4]

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[3] That Congress did not intend to exempt the net income of a business corporation by reason of the fact that it is distributable to a tax exempt organization is also confirmed by Code Section 23(q)(2), which limits allowable deductions by a corporation on account of contributions to organizations described in Section 101(6) to an amount not exceeding five per cent of its net income.

[4] See also *Allen* v. *Regents*, 304 U.S. 439; *New York* v. *United States*, 326 U.S. 572; *Scholarship Endowment Foundation* v. *Nicholas*, 106 F. 2d 552 (C.A. 10th), certiorari denied, 308 U.S. 623; *Stanford University Book Store* v. *Helvering*, 83 F. 2d 710 (C.A.D.C.); *Davenport Foundation* v. *Commissioner*, 170 F. 2d 70 (C.A. 9th); *Keystone Automobile Club*

To hold that a business corporation is itself exempt from tax because its stockholders are exempt would telescope into one the separate requirements of Section 101(6) that the corporation be organized and operated exclusively for the purposes there specified, and that no part of its net income inure to the benefit of a private shareholder. It would fuse the separate taxable entities of a corporation and its stockholders by ascribing to a corporation whose operations are purely commercial the charitable functions of its stockholders. It would render superfluous Section 101(14), which must be read in conjunction with 101(6). And it would attribute to Congress an intention, nowhere suggested in the statute, to discriminate among competing business enterprises by granting tax immunity to those whose stockholders happen to be tax exempt.

3. Although the decisions of the courts reflect a diversity of approach, the decision below does not appear to be in direct conflict with any decision of this Court or of any of the Courts of Appeals. The court below (R. 1066-1080) painstakingly reviewed the cases upon which taxpayer relies for conflict (Br. 15-28), including *Trinidad* v. *Sagrada Orden, supra,* and *Roche's Beach, Inc.* v. *Commissioner,* 96 F. 2d 776 (C. A. 2d), upon which taxpayer chiefly

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v. *Commissioner,* 181 F. 2d 402 (C.A. 3d); *Chattanooga Automobile Club* v. *Commissioner,* (C.A. 6th), decided June 1, 1950 (1950 C.C.H., par. 9335); *Smyth* v. *California Automobile Assn.,* 175 F. 2d 752 (C.A. 9th).

relies, and pointed out that they each presented material distinguishing features. It considered the instant case as bearing a closer resemblance to, and governed in principle by, those in which the claimed exemption was denied. *Better Business Bureau* v. *United States, supra; Underwriters' Laboratories* v. *Commissioner, supra; Bear Gulch Water Co.* v. *Commissioner, supra; Gagne* v. *Hanover Water Works Co., supra; Sun-Herald Corp.* v. *Duggan, supra.* Nor can it be said that a true conflict is presented by *Willingham* v. *Home Oil Mill,* 181 F. 2d 9 (C. A. 5th), decided after the decision below, and also relied upon by taxpayer. (Br. 19, 22.) That case was not decided on its merits alone, but also on the ground that the Government was estopped from challenging the taxpayer's claim to exemption by reason of a judgment in a prior suit. Insofar as the merits were concerned, the court assimilated the facts there presented to those in the *Roche's Beach* case and accordingly regarded that case as controlling. The court below differentiated the *Roche's Beach* case, and consequently felt no similar compulsion to treat it as dispositive of this case. That taxpayer was operated primarily for the benefit of the major oil companies which formerly owned its stock suffices in and of itself to distinguish this case from those relied upon by taxpayer.

4. Much of the confusion with respect to the basic problem is attributable to a misreading of *Trinidad*

v. *Sagrada Orden,* 263 U. S. 578. In that case, a religious organization that was otherwise tax exempt undertook, as a minor part of its activities, to sell wines and chocolates to its member churches. It was argued that these activities deprived the organization of its tax exempt status because it was not "operated exclusively" for religious purposes. In holding that the organization did not lose its exemption, there was language in this Court's opinion suggesting that the exemption depended not upon the "source of the income", but rather upon its "destination". 263 U. S. at 581. However, the gist of the opinion would appear to be found in the following language (p. 582):

> As respects the transactions in wine, chocolate and other articles, we think they do not amount to engaging in trade in any proper sense of the term. It is not claimed that there is any selling to the public or in competition with others. The articles are merely bought and supplied for use within the plaintiff's own organization and agencies,—some of them for strictly religious use and the others for uses which are purely incidental to the work which the plaintiff is carrying on. That the transactions yield some profit is in the circumstances a negligible factor. Financial gain is not the end to which they are directed.

Nevertheless, in view of the prior language that the "destination" rather than the "source" of the income was the test, a widespread practice has

arisen in recent years whereby commercial corporations actively engaged in competitive business have sought exemption, not because their activities were charitable but because of the "destination" of the income, their stock being owned by a charitable institution. We think that the *Sagrada Orden* case was never intended to award tax exempt status to such a business corporation. See the dissenting opinion of Judge Learned Hand, in *Roche's Beach, Inc.* v. *Commissioner, supra.*[5]

Respectfully submitted,

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JULY, 1950.

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[5] The *Roche's Beach* case was decided in 1938. Although contrary to the general position theretofore taken by the Bureau of Internal Revenue, the decision was at first accepted by the Treasury as a precedent in other cases involving substantially the same facts. Since 1942, however, the Treasury has refused to follow that decision. See G. C. M. 23063, 1942-1 Cum. Bull. 103.

APPENDIX

Internal Revenue Code:

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this chapter—

* * * * *

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

* * * * *

(14) Corporations organized for the exclusive purposes of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this chapter;

* * * * *

(26 U. S. C. 1946 ed., Sec. 101.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.101(6)-1. Religious, Charitable, Scientific, Literary, and Educational Organizations and Community Chests.—In order to be exempt under section 101(6), the organization must meet three tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes;

(2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and

(3) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor. The fact that a corporation established for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily deprive it of exemption.

An educational organization within the meaning of the Internal Revenue Code is one designed primarily for the improvement or development of the capabilities of the individual, but, under exceptional circumstances, may include an association whose sole purpose is the instruction of the public, or an association whose primary purpose is to give lectures on subjects useful to the individual and beneficial to the community, even though an associa-

tion of either class has incidental amusement features. An organization formed, or availed of, to disseminate controversial or partisan propaganda is not an educational organization within the meaning of the Code. However, the publication of books or the giving of lectures advocating a cause of a controversial nature shall not of itself be sufficient to deny an organization the exemption, if carrying on propaganda, or otherwise attempting, to influence legislation forms no substantial part of its activities, its principal purpose and substantially all of its activities being clearly of a nonpartisan, noncontroversial, and educational nature.

Since a corporation to be exempt under section 101(6) must be organized and operated exclusively for one or more of the specified purposes, an organization which has certain religious purposes and which also manufactures and sells articles to the public for profit, is not exempt under section 101(6) even though its property is held in common and its profits do not inure to the benefit of individual members of the organization. See section 101(18) as to religious or apostolic associations or corporations.

A corporation otherwise exempt under section 101(6) does not lose its status as an exempt corporation by receiving income such as rent, dividends, and interest from investments, provided such income is devoted exclusively to one or more of the purposes specified in that section.

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OCTOBER TERM, 1950

No. 159

UNIVERSAL OIL PRODUCTS COMPANY,
Petitioner,

vs.

NIGEL D. CAMPBELL and THE UNITED STATES OF AMERICA,
Respondents.

REPLY BRIEF OF PETITIONER ON PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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August 31, 1950.

CASES CITED

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STATUTE CITED

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REPLY BRIEF OF PETITIONER ON PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The "Memorandum for the Respondents" suggests a short reply.

Respondents concede (M. 9)* that *"the broad question to which the petition for certiorari is addressed,* namely, whether a business corporation is to be deemed 'organized and operated exclusively' for the purposes specified in Section 101(6) solely by reason of the transfer of its stock to a tax exempt organization * * * *is of general importance, and one with respect to which the decisions of the lower courts are inconclusive."***

Respondents also state (M. 9):

> "Should this Court be disposed to reach and resolve it [the above stated question] in this kind of case, the Government would have no objection to the granting of the writ for that purpose."

*Citations to "M. " refer to "Memorandum for the Respondents."

**Italics supplied unless otherwise indicated.

Again Respondents state (M. 12):

> "* * * the decisions of the courts reflect a diversity of approach * * *".

The Government has just filed in this Court a petition for a writ of *certiorari* (Dkt. No. 257, October Term, 1950) to review *Willingham* v. *Home Oil Mill*, 5 Cir., 181 F. 2d 9, upon the decision of which in the Court of Appeals Petitioner relies, *inter alia*, as clearly in conflict with the case at bar.

In its petition in the *Home Oil* case the Government states (p. 2) as the first of "Questions Presented" the following:

> "Whether a business corporation carrying on competitive commercial activities for profit becomes exempt from federal income tax under Section 101(6) of the Internal Revenue Code by reason of the transfer of its stock to an organization which is tax exempt."

In spite of the foregoing, the Government, in its Memorandum addressed to the instant Petition, seeks to distinguish it from other decisions of various courts of appeals in which exemption has been granted to stock corporations (P. B. 15-28).*

The Government's argument in this regard is that the former stockholders of Petitioner are "licensed" to use Petitioner's patents "free of charge" (M. 2, 7-9). This assertion has been answered in our Petition (P. B. 4, 27-28).

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*Citations "P. B. " refer to the "Petition for a Writ of *Certiorari* to the United States Court of Appeals for the Seventh Circuit and Brief in Support Thereof", filed by Petitioner in the instant case.

There we showed that the agreements referred to by Respondents were in general cross-immunity agreements, made many years before the dedication of Petitioner's earnings to a concededly exempt purpose, and were supported on both sides by ample consideration; that such agreements were not confined to security holders, but were entered into indiscriminately with oil companies which were never security holders; that none of the oil companies was granted immunity free of charge; that they all paid for it,—in some instances by return grants of a similar nature and in other instances by grants to Petitioner of affirmative licensing rights and by cash payments aggregating $10,000,000 (R. 651, 678-9). Those transactions were consummated, not for the purpose of benefiting former security holders but, as shown in our Petition and uncontradicted in the record, for the purpose of securing and improving Petitioner's position in the industry.

Respondents suggest that perhaps *C. F. Mueller Co.*, 14 T. C. No. 111½, decided May 25, 1950, a Tax Court case, might be a more appropriate vehicle for decision by this Court (M. 9). That case, however, has not been decided by the Court of Appeals and may never reach this Court. In any event, the *Mueller* case does not differ essentially from the case at bar or other conflicting decisions, such as *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue*, 2 Cir., 96 F. 2d 776; *Commissioner of Internal Revenue* v. *Orton*, 6 Cir., 173 F. 2d 483 and *Willingham* v. *Home Oil Mill*, *supra* (see P. B. 27-28).* In all the foregoing cases, the taxpayers, since they were all in business, necessarily had

*Parenthetically, the Tax Court in the *Mueller* case stated that the Court of Appeals in the case at bar had acted "contrary to the holding of the Court of Appeals for the Second Circuit in the *Roche's Beach* case."

commitments outstanding at the time their earnings were dedicated to an exempt purpose.

It is therefore submitted that a conflict exists between the Second, Fifth, Sixth and Seventh Circuits upon the important question of exemption of a stock corporation under Section 101(6) of the Internal Revenue Code.

Respondents devote a considerable part of their argument (M. 9-12) to a presentation of the merits of the principal controversy, namely, "whether a business corporation becomes tax exempt by virtue of the acquisition of its stock by a tax exempt organization".

We deem it inappropriate upon a petition for a writ of *certiorari* to make an extensive argument upon the merits of that question.

Suffice it to say, however, that the cases relied on by Respondent in this respect are, with the possible exception of the *Mueller* case and *Trinidad* v. *Sagrada Orden,* 263 U. S. 578, on which latter case Petitioner as well as Respondent rely, easily distinguished. *Better Business Bureau* v. *U. S.,* 326 U. S. 279 (M. 11), held that the taxpayer was not exempt from social security taxes since the ultimate object ("destination") of its activities, unlike that of Petitioner, was commercial. In *Bear Gulch Water Co.* v. *Commissioner of Int. Rev.,* 9 Cir., 116 F. 2d 975, *cert. den.* 314 U. S. 652 (M. 11), the issue of exemption under 101(6) does not appear to have been fully litigated. In that case, according to the Government's brief in opposition to petition for writ of *certiorari,* the express finding of the Board of Tax Appeals that taxpayer was neither directly organized for educational purposes nor was its income to be so applied was "undisputed". Furthermore, part of taxpayer's stock in that case was purchased by the exempt organization

merely as an investment and was not, as in the case at bar, dedicated in perpetuity to an exempt purpose, subject only to determination by a court of competent jurisdiction that changed conditions render the continued holding of the stock contrary to the public welfare (Exh. A, Art. Fourth). In the *Bear Gulch* case the stock could have been sold by the exempt organization at any time.

In *Gagne* v. *Hanover Water Works Co.*, 1 Cir., 92 F. 2d 659 (M. 11), it was held that a corporation which derived its income from the sale of water was not organized for the exclusive purpose of holding title to property, collecting the income and turning over the entire amount to an exempt organization, within the meaning of Section 101(14).

In *Underwriters' Laboratories* v. *Com'r of Int. Rev.*, 7 Cir., 135 F. 2d 371, *cert. den.* 320 U. S. 756, the taxpayer was organized by the National Board of Fire Underwriters, composed of fire insurance companies. It conducted research with respect to insurance risks and operated a testing service for manufacturers in return for ample fees. The court held that taxpayer was operated primarily for the benefit of private parties, the insurance companies, and not, as here, for a purely exempt purpose.

Sun-Herald Corporation v. *Duggan* (two cases), 2 Cir., 73 F. 2d 298, *cert. den.* 294 U. S. 719, and 160 F. 2d 475 (M. 11), involved claims for exemption under Section 101(14). The only pertinent point in the first case was the remark by the court that the word "organized" when used in subdivision 14 means "incorporated". Thereafter the same court decided the *Roche's Beach* case where, in granting exemption under Section 101(6), the court held that extrinsic evidence as to the purpose of the organiza-

tion was admissible even though the stated purpose made no reference to the charitable character of the corporation. In the second *Sun-Herald* case the court acknowledged that it had modified in the *Roche's Beach* case its pronouncement in the earlier *Sun-Herald* case.

We have not attempted by the foregoing to argue the case *in extenso* upon the merits but we believe that, both in the cases cited in our Petition and those distinguished above, a sufficient indication for present purposes has been given of at least one of the lines of argument upon the merits which we shall make if the writ is issued.

If the Petition is granted, we shall also argue that a comparison of the provisions of the various subdivisions of Section 101 of the Internal Revenue Code demolishes the Government's basic argument and demonstrates that Section 101(6) contemplates the exemption of a stock corporation organized for profit where its net earnings inure only to the benefit of an exempt organization.*

In its petition in the *Home Oil* case, the Government attempts to show that that case is complicated by an issue of collateral estoppel or *res judicata*. Examination of the decision of the Court of Appeals will disclose that, though the court held that the case might be decided on the ground of collateral estoppel, it might equally well rest "solely upon the authority of the majority opinion in Roche's Beach, Inc. v. Commissioner, 2 Cir., 96 F. 2d 777 * * *. Without doubt, the Roche's Beach decision establishes the right of Home Oil Mill to the refund sought." Evincing, however, its recognition of the basic issue in that case, the Government has specified as the first and second errors of the

*We do not here, of course, purport to outline the scope of our entire argument on the merits. That is set forth in "Questions Presented" in our Petition and in "Specification of Errors" in our Brief.

Court of Appeals its failure to decide that a business corporation carrying on competitive commercial operation for profit was not exempt under Section 101(6).

Finally, in its petition in the *Home Oil* case, the Government says of the instant case (p. 6):

> "* * * the Government is not opposing the granting of the writ in that case should this Court be willing to go beyond the facts there involved and undertake to decide the basic question of whether an ordinary business corporation becomes exempt from federal income tax under Sections 101(6) and 101(14) of the Internal Revenue Code * * * merely because its stock is acquired by a tax exempt organization."

The importance of deciding the basic question involved in both this case and in the *Home Oil* case suggests, we respectfully urge, that the Petition be granted and the writ issued. If the Court should deem it advisable to await the *Mueller* case, then we pray, as we understand the Government does in the *Home Oil* case, that the writ be granted here, argument to be deferred, however, until the *Mueller* case is heard.

Respectfully submitted,

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